



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR  
SPECIAL LITIGATION ASSISTANT

FROM: Deborah A. Butler  
Assistant Chief Counsel (Field Service) CC:DOM:FS:CORP

SUBJECT: Acceleration Rule

This Field Service Advice responds to your memorandum dated September 17, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Corp A =

Corp B =

Corp C =

Corp D =

State A =

State B =

Date 1 =

\$a	=
\$b	=
Corp E	=
\$c	=
X	=
Year 1	=
\$d	=
Corp F	=

## ISSUES

1. Whether the Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in \_\_\_\_\_ under Treas. Reg. § 1.1502-13(d) upon the distribution of loss property from Corp D to Corp A, and Corp A's contemporaneous sale of its stock in Corp D to Corp F.
2. Assuming the Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in \_\_\_\_\_ under Treas. Reg. § 1.1502-13(d), whether Corp A in calculating its gain or loss on the sale of the Corp D stock, must reduce its basis in the Corp D stock by the amount of the ordinary loss under Treas. Reg. § 1.1502-32(b)(2)(i) and by the fair market value of the "X Property" distributed to Corp A by Corp D under Treas. Reg. § 1.1502-32(b)(2)(iv) (Assuming Corp A does not wish to include the fair market value of the "X Property" distributed to it in Corp A's income, under Treas. Reg. § 1.1502-13(f)(2)(ii).).

## CONCLUSIONS

1. The Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in \_\_\_\_\_ under Treas. Reg. § 1.1502-13(d) upon the distribution of loss property from Corp D to Corp A, and Corp A's contemporaneous sale of its stock in Corp D to Corp F.
2. Assuming the Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in \_\_\_\_\_ under Treas. Reg. § 1.1502-13(d), Corp A in calculating its gain or loss on the sale of the Corp D stock, must reduce its basis in the Corp D stock by the amount of the ordinary loss under Treas. Reg. § 1.1502-32(b)(2) and by the fair market value of the "X Property" distributed to Corp A by Corp D under

Treas. Reg. § 1.1502-32(b)(2). (Assuming Corp A does not wish to include the fair market value of the “X Property” distributed to it in Corp A’s income, under Treas. Reg. § 1.1502-13(f)(2)(ii).)

### FACTS

Corp A is the common parent of the group of affiliated corporations making a consolidated return, pursuant to the provisions of I.R.C. § 1502 and the regulations thereunder.

Corp A in Year 1 acquired the stock of the Corp B, a State A corporation, from Corp C, an unrelated entity, for \$a. Corp A renamed the company Corp D.

In Date 1, Corp A entered into an agreement to sell all of the stock of Corp D to Corp F Company, an unrelated State B corporation, for a base purchase price of \$b. At the time, Corp D’s only assets were the stock of Corp E, a State B corporation, and properties referred to alternatively as the “X Property”.

The Stock Purchase agreement provides in pertinent part, that one minute prior to closing, Corp D will distribute the X Property to its parent Corp A. At the time of this distribution, the fair market value of the X Property was \$c. Corp A then sold the stock of Corp D to Corp F, and Corp D thereby left the consolidated group. The X Property, however, remained with the Corp A consolidated group following the stock sale.

### LAW

Treas. Reg. § 1.1502-13, “Intercompany transactions”, provides rules for taking into account items of income, gain, deduction, and loss among members of a consolidated group. The purpose of the regulation is to prevent intercompany transactions from creating, accelerating, avoiding or deferring consolidated taxable income. Treas. Reg. § 1.1502-13(a)(1). Under this section, the selling member, (S) and the buying member (B) are treated as separate entities for some purposes but as divisions of a single corporation for other purposes. Treas. Reg. § 1.1502-13(a)(2). The amount and location of S’s intercompany items and B’s corresponding items are determined on a separate entity basis, but the timing, character, source and other attributes of the intercompany items and corresponding items are redetermined under Treas. Reg. § 1.1502-13 to produce the effect of transactions between a single corporation.

Intercompany transactions include S’s distribution to B with respect to S Stock. Treas. Reg. 1.1502-13(b)(1)(i)(D).

The principle rules which implement single entity treatment are the matching rule of Treas. Reg. § 1.1502-13(c) and the acceleration rule of Treas. Reg. § 1.1502-13(d) and Treas. Reg. § 1.1502-13(a)(6)(i). Under the matching rule, S and B are treated as divisions of a single corporation for purposes of taking into account their items from intercompany transactions. The acceleration rule provides additional rules for taking items into account if the effect of treating S and B as divisions cannot be achieved. (for example if S or B becomes a nonmember)

The acceleration rule of Treas. Reg. § 1.1502-13(d) provides that S's intercompany items and B's corresponding items are taken into account under its provisions "to the extent they cannot be taken into account to produce the effect of treating S and B as divisions of a single corporation." The items are taken into account immediately before it first becomes impossible to achieve this effect, and for purposes of the rule, the effect cannot be achieved to the extent an intercompany item or corresponding item will not be taken into account in determining the group's consolidated taxable income under the matching rule. (For example, if S or B becomes a nonmember.)

Treas. Reg. § 1.1502-13(f) provides additional rules with respect to the stock of members of the consolidated group.

Treas. Reg. § 1.1502-13(f)(2)(i) provides that a "distribution is not an intercompany distribution to the extent it is deducted by the distributing member." Treas. Reg. § 1.1502-13(f)(2)(ii) provides that an intercompany distribution is not included in the gross income of the distributee member (B). However, this exclusion applies to a distribution only to the extent there is a corresponding negative basis adjustment reflected under Treas. Reg. § 1.1502-32 in B's basis in the stock of the distributing member (S).

Treas. Reg. § 1.1502-13(f)(2)(iii) provides that the principles of I.R.C. § 311(b) apply to S's loss as well as gain, from an intercompany distribution of property. Thus S's loss is taken into account under the matching rule if the property is subsequently sold to a nonmember.

I.R.C. § 311(b) provides generally for the recognition of gain by the distributing corporation in the event it distributes appreciated property to the shareholder. Treas. Reg. § 1.1502-13(f)(2)(iii) extends this recognition to loss property as well, if the property is subsequently sold to a non member.

Treas. Reg. § 1.1502-32(a) sets forth the rules for adjusting a parent corporation's basis in the stock of its subsidiary (investment basis adjustments). Under Treas. Reg. § 1.1502-32(b)(2), the parent's basis in its subsidiary's stock is increased by positive adjustments and negative adjustments. The adjustment is made annually, in the net amount of the subsidiary's: (i) taxable income or loss; (ii) tax-exempt

income; (iii) noncapital, nondeductible expenses; and (iv) distributions with respect to S's stock.

## Law and Analysis

### Issue 1-entitlement to claim an ordinary loss.

This issue involves whether the Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in 1996 under Treas. Reg. § 1.1502-13(d) upon the distribution of loss property from Corp D to Corp A, and Corp A's contemporaneous sale of its stock in Corp D to Corp F.

Intercompany transactions include S's distribution to B with respect to the S stock. Treas. Reg. § 1.1502-13(b)(1)(i)(D). Therefore, the Date 1 Corp D distribution of the X property to Corp A is an intercompany transaction under Treas. Reg. § 1.1502-13(b)(1)(i)(D).

Treas. Reg. § 1.1502-13(f)(2)(iii) provides that the principles of I.R.C. § 311(b) apply to S's loss as well as gain, from an intercompany distribution of property. Thus S's loss is taken into account under the matching rule if the property is subsequently sold to a nonmember.

In the instant case, Corp A's subsidiary, Corp D distributes the X property, with a fair market value less than its adjusted basis at the time of distribution, to Corp A just prior to the sale of the Corp D stock, not the sale of the X property.

We would interpret the reference to "property" in Treas. Reg. § 1.1502-13(f)(2)(iii), not to refer to the stock of Corp D, but rather to the X Property distributed by Corp D to Corp A. Since Corp A has not sold the X property outside the Corp A group, Treas. Reg. § 1.1502-13(f)(2)(iii) does not provide authority for the Corp A group's deduction of the "X Property" loss.

However, the acceleration rule of Treas. Reg. § 1.1502-13(d) provides that S's intercompany items and B's corresponding items are taken into account under its provisions "to the extent they cannot be taken into account to produce the effect of treating S and B as divisions of a single corporation." The items are taken into account immediately before it first becomes impossible to achieve this effect, and for purposes of the rule, the effect cannot be achieved to the extent an intercompany item or corresponding item will not be taken into account in determining the group's consolidated taxable income under the matching rule. (For example, if S or B becomes a nonmember.) Because the effect of treating S and B as divisions of a single corporation cannot be produced once S becomes a non

member, S takes its gain or loss on the property into consolidated taxable income immediately before becoming a nonmember. (S's accelerated gain or loss is reflected in B's basis in the S stock.) (Treas. Reg. § 1.1502-32)

Therefore, Corp A's sale of the Corp D stock to Corp F triggers the acceleration rule under Treas. Reg. § 1.1502-13(d), since the "selling" member (Corp D), by virtue of the stock sale, leaves the Corp A consolidated group.

Because the effect of treating Corp D and Corp A as divisions of a single corporation cannot be produced once Corp D becomes a non member, Corp D's loss on the "X Property", which it distributed to Corp A, will be taken into the Corp A group's consolidated taxable income immediately before Corp D became a nonmember of the Corp A group. (Corp D accelerated loss is reflected in Corp A's basis in the Corp D stock.) (Treas. Reg. § 1.1502-32)

Therefore, we agree that Treasury Reg. § 1.1502-13(d) requires that Corp D recognize the loss upon the distribution of the X Property to Corp A, (Therefore, the Corp A and Subsidiaries consolidated group will be able to claim this loss.) since Corp D, by virtue of the stock sale immediately following the distribution, leaves the Corp A consolidated group.

#### Issue-2 Basis reduction in Corp D stock

This issue involves, assuming the Corp A & Subsidiaries consolidated group is entitled to claim an ordinary loss in 1996 under Treas. Reg. § 1.1502-13(d), whether Corp A in calculating its gain or loss on the sale of the Corp D stock, must reduce its basis in the Corp D stock by the amount of the ordinary loss under Treas. Reg. § 1.1502-32(b)(2)(i) and by the fair market value of the "X Property" distributed to Corp A by Corp D under Treas. Reg. § 1.1502-32(b)(2)(iv). Assuming Corp A does not wish to include the fair market value of the "X Property" distributed to it in Corp A's income, under Treas. Reg. § 1.1502-13(f)(2)(ii).

#### Distribution

Intercompany transactions include S's distribution to B with respect to the S stock. Treas. Reg. § 1.1502-13(b)(1)(i)(D). Therefore, the Date 1 Corp D distribution of the X property to Corp A is an intercompany transaction under Treas. Reg. § 1.1502-13(b)(1)(i)(D).

Treas. Reg. § 1.1502-13(f)(2)(i) provides that a "distribution is not an intercompany distribution to the extent it is deducted by the distributing member." In the instant case, Corp D did not deduct the distribution of the "X Property".

[REDACTED]

Treas. Reg. § 1.1502-13(f)(2)(ii) provides that an intercompany distribution is not included in the gross income of the distributee member (B). However, this exclusion applies to a distribution only to the extent there is a corresponding negative basis adjustment reflected under Treas. Reg. § 1.1502-32 in B's basis in the stock of the distributing member (S).

Treas. Reg. § 1.1502-32(a) sets forth the rules for adjusting a parent corporation's basis in the stock of its subsidiary (investment basis adjustments). Under Treas. Reg. § 1.1502-32(b)(2), the parent's basis in its subsidiary's stock is increased by positive adjustments and negative adjustments. The adjustment is made annually, in the net amount of the subsidiary's: (i) taxable income or loss; (ii) tax exempt income (iii) non capital non deductible expenses (iv) distributions with respect to S's stock.

Therefore, we agree that if Corp A does not wish to include the fair market value of the "X Property" distributed to it in Corp A's income, under Treas. Reg. § 1.1502-13(f)(2)(ii), then Corp A in calculating its gain or loss on the Corp D stock must reduce its basis in the Corp D stock by the fair market value of the "X Property" distributed to it with respect to the Corp D stock under Treas. Reg. § 1.1502-32(a)(iv).

#### Ordinary loss

Under Treas. Reg. § 1.1502-32(b)(2)(i) the parents basis in its subsidiary's stock is increased by positive adjustments and decreased by negative adjustments in the net amount of the subsidiary's net income or loss.

Assuming that Corp A is entitled to a claimed loss in the amount of \$d, Under the provisions of Treas Reg. § 1.1502-32(b)(2)(i), we agree that Corp A must reduce its basis in the Corp D stock by the amount of \$d.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

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[REDACTED]

Please call if you have any further questions.

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By: \_\_\_\_\_  
ARTURO ESTRADA  
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